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Rethinking Free Trade

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"Nothing is built on stone; all is built on sand, but we must build as if the sand were stone."

~ Jorge Luis Borges (Argentinian Poet 1899-1986)

Abstract

This paper examines the present theories and shortcomings of current free trade policy, and the consequences thereof, which promote protectionist behavior among countries on an international scale. Theoretically, free trade should encourage progress within the global community. However, developing countries, with astonishing growth rates, like Brazil, China or India, have based their economies on opposing economic policies, closer to mercantilism than liberalization or free trade, allowing for poor countries to question whether free trade is the right way to improve their economies. Furthermore, a huge gap exists between what developed countries preach and what they practice, presenting a major obstacle to more effective economic practice.

Consequently, because developed countries are unwilling to subscribe to an international judicial system to regulate commercial trade or improve the most-favored nation clause benefits of the General Agreement on Tariffs and Trade (GATT), developing countries are now attempting to gather in blocks led by middle-income countries in order to enforce their economic interest by applying tariff barriers as retaliation.[1] It cannot be ignored that poverty is rapidly increasing in

[1] "**Enforcement mechanism of WTO: it did not punish violators, but it authorized countries that had suffered injury as a result of a violation to retaliate by imposing trade restrictions on the offending country... The threat has worked remarkable well. The first step toward a rule of law in international trade was the great achievement of Uruguay Round. Without a rule of law, brute**

developing countries; the most effective way to remedy the situation is through a fair international commercial trade system.

Because of the international economic crisis, which reached a global scale in the 1990s, the institutions created after Bretton Woods, the World Bank and the International Monetary Fund, now face the necessity of deep reform.

This paper supports globalization and free trade as a means of progress, viewing the world as a singular business community. There has been wide discussion regarding the pros and cons of globalization; targeting the protectionist tendencies which developing and developed countries implement in certain sectors of their economies has become a common issue in international forums.

Joseph E. Stiglitz's "Making Globalization Work" and "Globalization and its Discontents," and Paul Krugman's "The Return of Depression Economics and the Crisis of 2008," accurately explain how trade liberalization advocates have failed, but do not provide sustainable solutions. Milton Friedman's book "Capitalism and Freedom" sublimely promote free trade, but hinders itself within the constraints of fundamentalism. Thomas Schelling's "The Strategy of Conflict," which improved upon John Nash's "Non-Cooperative Games," portrays how developed countries prefer protectionism over free trade. Finally, David Smick's "The World is Curve," illustrates various means of how financial stability could be provided to the world.

The economic crisis of 2008 created profound questions about the future of international trade transactions. Four important criteria could change in the way business transactions function:

powers win. The WTO's international law is an imperfect rule of law, the rules are derived from bargaining, including bargaining between the rich and the poor countries and in that bargaining it is the rich and powerful that typically prevail." (Joseph E. Stiglitz, Making Globalization Work, 76, Norton paperback 2007).

climate change, agriculture, reform in international organizations created in Bretton Woods, and a new system of dispute resolution within the World Trade Organization. The prevalent form of capitalism is at its tipping point, and it must evolve in order to survive.

It is possible to address the apparently endless disparity between developed or rich countries and developing or poor countries by applying current ideas on present free trade issues to give practical solutions.

Generally speaking, all attempts to establish an international judicial system, which would comprehensively and uniformly regulate international trade, have not worked to date. The current system is discordant at best and offers no good perspective in the short term. "In the long run," as the British economist John M. Keynes has forewarned us, "we are all dead."[2] The need to address current international trade issues is immediate, and is not beneficial unless it happens now.

The actual trade system is reminiscent of the colonial system where developing countries are doomed to functioning in an agro-export capacity, with no access to industrial and technological knowledge and opportunities. Each state's function is clearly manipulated by a directed economy, in which developed countries make all decisions based on what they need, which is the production and consumption of goods. Developing countries are basically the net suppliers of food and fuel provided that they not compete against developed countries' farmers, neither in industry nor technology.

Three strong economic and political theories struggled for their primacy during the 20th century: nationalism, communism and capitalism in its various forms, and the latter resulted victorious.

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[2] **John Maynard Keynes, A Tract on Monetary Reform (1923) Ch. 3.**

With capital as the necessary motor power of today's economies, the challenge for the 21st Century is discovering an alternative to the current form of capitalism to provide the best possible world in which to live.

In order to be succinct, I have skipped the critique of -isms such as nationalism and communism, and vanished theories applied unsuccessfully in several developed and developing countries. I consider them extinct theories, so following Anton Chekhov's advice "*Of the dead, speak no evil.*"[3]

Analysis

The crash of the Soviet Union in 1991 was taken as a singular triumph by neo-liberal academics, politicians and technocrats. This enthusiasm was indomitable, and these extreme ideas were rapidly propagated around the world through its international economic organizations, the World Bank and the International Monetary Fund among others. From Argentina to South Korea, from Mexico to Indonesia and Russia, a huge economic crisis exploded, victim of the same policies: high fiscal deficit and dependence of volatile inflows of capital.

These neo-liberals defended their ideas, accusing countries affected by this crisis for lacking strong institutions or having corrupt governments. Consequently, this erroneous perception of the problem has propagated the present economic crisis affecting the United States and Europe.

Argentina depicts an emblematic case. In the 1990s, the Minister of Finance of the new government in Argentina, a Ph.D from Harvard, applied a trendy ideology, neo-liberalism, directly from its manual: privatization, austerity, trade liberalization (or liberalization of imports)

[3] **Anton Chekhov, The Seagull, Act 1**

and capital inflows supporting budget deficit. In the short term, this boosted domestic industry greatly. At the time, however, the Argentine government didn't define the terms of the capital inflows being received. Short term capital is extremely volatile, and leaves the country at the hint of minimal political stress; hence, it helps little or nothing in the long term, which is needed in developing countries. Consequentially, companies closed and laid off employees because they couldn't compete against the more sophisticated and developed companies from developed countries.

Among those conservative intellectuals fueling the neo-liberalist movement, the most important was the Nobel Prize winner Milton Friedman, called by Fortune magazine "the economist of the century." An ardent admirer of Ayn Rand (laissez-faire capitalism and, minimal government interference), in his book "Capitalism and Freedom", Friedman set forth the theory that governed the liberalization of markets around the world, and minimized the participation of governments in regulation thereof, which became most apparent in the 1980s and 1990s, and which would later implode in the United States' economy in 2008. The minimal or absent regulation of the markets doctrine that they propelled affected the development of a free trade system and the entire world economically.

Another Nobel Prize recipient, Joseph Stiglitz, in his book "Making Globalization Work," explains accurately how trade liberalization advocates failed in their determinations that prosperity in developing countries would be achieved by opening up to exports. Also, and more intensively, why there has been no free trade yet.[4]

[4] **In part, free trade has not worked because we have not tried it: trade agreements of the past have been neither free nor fair. They have been asymmetric, opening up markets in the developing countries to goods from the advanced industrial countries without full reciprocation. A host of subtle but effective trade barriers has been keeping in place. This asymmetric globalization has put**

Protectionism is economic nationalism. Moving from protectionism to free trade, from developing to becoming a developed country, is laden with hurdles.

During the Uruguay Round in 1995, the World Trade Organization established the Agreement on Technical Barriers to Trade ("TBT Agreement") to ensure that regulations and other procedures would not create unnecessary obstacles to trade. The agreement prohibits technical requirements created in order to limit trade, as opposed to technical requirements created for legitimate purposes such as consumer or environmental protection.[5] It also contains exceptions, which constitute a critical obstacle to the export of agricultural products.

In their defense, neo-liberals have been coherent with their postulates; apply mathematics in order to analyze human behavior and then design economic policies. Taken to the extreme, these postulates catalyze the malfunction of international trade and financial institutions.

Analyzing Free Trade by Game Theory

Applying the game theory through the prisoner dilemma model makes it possible to understand the choice of protectionism over of free trade. In a scenario where free trade governs, we have the first prisoner's chess match, and where protectionism prevails, the second prisoner's chess match.

As an example of how the system functions, in figure 1, A represents developed countries (promoters of free trade in industry and services) and B represents developing countries

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developing countries at a disadvantage. It has left them worse off than they would be with a truly free and fair trade regime. (Joseph E. Stiglitz, Making Globalization Work, 62 Norton paperback 2007).

[5] **http://www.wto.org/english/tratop_e/tbt_e/tbt_e.htm**

(generally protectionist in industry and services). The results are *a*, *b*, *c* and *d*. The first resulting number represents A's revenue, and the second is B's revenue. R is the benefit of one country doing business in another country, and C is the cost of letting another country do business in one's own domestic market.

Table 1 – Game Theory in the World Trade System

	Country A			
Country B	**Trade Protection**		**Free Trade**	
Trade Protection	*a*	0, 0	*b*	–C, R
Free Trade	*c*	R, –C	*d*	R –C, R–C

When a developing country implements protectionist measures and a developed country practices free trade, the result is that the developing country benefits and the developed country carries the cost. On the other hand, when a developed country adopts free trade and the developing country does so as well, the principal beneficiary of this action is the developed country, because it maximizes its relative profits.

Therefore, the best match choice for a developed country is always *c* or *d*, in which they can obtain a maximum profit; hence, the prevalent match in the diagram (or more broadly applied, in international trade transaction) is the second prisoner's chess match.[6]

[6] **Lu, Zhang and Jia; Analyzing the Birth of TBT by Game Theory. Chinese Business Review, volume 6, no 5. May 2007 Also see: Schelling, Thomas, The Strategy of Conflict, 1960, Harvard University. Nash, John (1950) "Non-Cooperative Games" The Annals of Mathematics 54(2);286-295.**

As Thomas Schelling describes in his book The Strategy of Conflict, “we all are, in fact, participants in international conflict, and we want to “win” in some proper sense. …We may wish to control or influence the behavior of others in conflict, and we want, therefore, to know how the variables that are subject to our control can affect their behavior.”[7]

Schelling emphasizes a deterrent threat in this game theory, where each participant depends on what he expects the other participant to do. Applying this logic, the deterrent threat theory means having influence over the other participant. He continues, “The deterrence concept requires that there be both conflict and common interest between the parties involved.”[8]

Finally, he tries to soften words by using “strategy” of conflict and threat. “…though strategy of conflict sounds cold-blooded, the theory is not concerned with the efficient application of violence or anything of the sort. …in using the word “threat” I have not intended any necessarily aggressive or hostile connotations.”[9] Any analogy with developed countries’ behavior in international trade is a simple coincidence.

For the purpose of this analysis, trade includes import and export. It is erroneous to believe that export alone is the way to success. Though export is very important, internal demand is also crucial. It is necessary to find a balance in the asymmetric result of how developed countries import more products from developing countries, while at the same time improving their benefits from those imports. In developed countries with open markets, the consumers receive the best quality products for the lowest price. "It is the maxim of every prudent master of a family never

[7] Thomas Schelling, The Strategic of Conflict,” pags. 3 and 4.
[8] Thomas Schelling, The Strategic of Conflict,” pag 11.
[9] **Thomas Schelling, The Strategic of Conflict,” pag 15.**

to make at home what it will cost him more to make than to buy... If a foreign country can supply us with a commodity cheaper than we ourselves can make it, better buy it of them."[10]

The issue is resolving how poor and rich, developing and developed countries can equally benefit from free trade. Another point to address is whether liberalizing the market will translate into growth within the market.

Some practices present a big political impact but few practical solutions. "There are many impediments facing those in the developing world. There is often a lack of infrastructure to bring their goods to market, and it may take years for the goods they produce to meet the standards demanded by the advanced industrial countries. These are among the reasons that when, in February 2001, Europe unilaterally opened up its markets to the poorest countries of the world, almost no new trade followed. To fulfill the promise that more trade will follow from trade liberalization, much else is required."[11]

For instance, "GATT focused on liberalization of trade in manufactured goods, the comparative advantage of the advanced industrial countries. There was limited trade liberalization in the areas important for developing countries, such as agriculture and textiles. Textiles remained subject to strong limits (quotas) on a country-by-country, product-by-product basis; likewise, agriculture remained highly protected and subsidized."[12] The issue that the international arena faces now is not only of free trade, but of a more fair and honest trade.

A solid policy increasing public disbursement in education, research and infrastructure (like ports and roads) will allow developing countries to achieve a high level of competitiveness, in

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[10] **Adam Smith, The Wealth of Nations (Bantam Classic Mass Market Paperback) (1776).**
[11] **Joseph E. Stiglitz, Making Globalization Work, 63 Norton paperback 2007.**
[12] **Joseph E. Stiglitz, Making Globalization Work, 75 Norton paperback 2007.**

which its outcome will benefit consumers all around the world. Naturally, there is significant opposition to public expenditures, but the government is the best qualified institution to allocate public assets in order to improve the nation's infrastructure, and transform agricultural economy into industrial economy. The World Bank has a significant role to play in lending directed to that endeavor.

The World Bank must also improve its function in the difficult process of guiding developing countries to becoming competitive as they face enormous difficulties, such as the access of their companies to the movement of capital, in that there is a deficient market of loans for small and medium business as well.

To resolve these issues, it is necessary to implement determined measures and requirements to be competitive. Also, developing countries need to be authorized and supported in protecting their economies from imports. Developing countries can find and should implement in the GATT Agreement authorized mechanisms that resolve the balance of payment issues by imposing temporary import controls and therefore arrange industries, like the Article XVIII which allows them to "control the general level of its imports by restricting the quantity or value of merchandise permitted to be imported; Provided that the import restrictions instituted, maintained or intensified shall not exceed those necessary:

(*a*) to forestall the threat of, or to stop, a serious decline in its monetary reserves, or

(*b*) in the case of a contracting party with inadequate monetary reserves, to achieve a reasonable rate of increase in its reserves."

The Improvement of the Dispute Resolution System under the GATT/WTO

The World Trade Organization was created primarily as a mechanism to regulate economic international relations out of necessity to fill the gap in international trade, which the World Bank and the International Monetary Fund failed to address as they lacked some of the policy tools needed.[13]

The question is whether a country, more precisely a developing country, can resolve a conflict under the WTO system with respect to its products entering into a developed country, which could establish barriers against those goods. Because of its importance and in light of weakness in the process, the dispute resolution system under the WTO is examined here. Improvement in the dispute resolution procedure under the GATT/WTO with a real enforcement of its decisions is necessary to promote international business transactions and will provide a sense of justice and confidence in the international trade system. With the adoption of the Dispute Settlement Understanding (DSU) in the Uruguay Round agreements, the WTO created a new agency, the Dispute Settlement Body (DSB).[14]

Acting as a first response in dispute there are tribunal ad hoc panels composed by experts who are not citizens of the states' parties. The Treaty regulates this in the articles XXII and XXIII. Panel decisions can be appealed to the Standing Appellate Body. The DSB will approve panel decisions unless there is consensus on the contrary. The DSB recommends to the losing party

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[13] **"But WTO is markedly different from the other two organizations. It does not set rules itself; rather, it provides a forum in which trade negotiations go on and it ensures that its agreements are lived up to." Joseph E. Stiglitz, Globalization and its Discontents. 2003.pag. 16.**

[14] **(See Vagts, Dodge, Koh. Foundation Press , Transnational Business Problems, Fourth Edition, pag. 136.)**

"withdraw the offending measure." Then, the losing party has 15 months to execute the decision; otherwise it could suffer retaliation from the other party.[15]

In the midst of this process, there are different kinds of settlement that the parties involved can reach, like consultations. Even though the arbitration resolution of dispute is a second option within the system, it is not mandatory, but relies of the members' circumspection.

There are a plethora of problems with this system, such as the risk to be misused, the requirement of exhausting different settlement mechanisms before going to the panel, or its ambiguity. The current role of the arbitrator in the GATT dispute resolution system is more like a mediator than an arbitrator. Furthermore, the threat of retaliation is not sufficient to avert countries from disobeying the agreement.[16]

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[15]Joseph E. Stiglitz, Making Globalization Work, 63 Norton paperback 2007). Most important, for the first time there was an effective-if limited-enforcement mechanism. The WTO did not itself punish violators, but it authorizes countries that had suffered injury as a result of the violation to retaliate by imposing trade restriction on the offending country. … Enforcement is asymmetric – a threat of trade restriction by the U.S. against a small country like Antigua will elicit a response, but the U.S. does not pay much attention if Antigua threatens a trade restriction.

[16] **(Zekos, Georgios I "An Examination of GATT/WTO Arbitration Procedures," Dispute Resolution Journal. (2009) "it could be said that GATT arbitration procedure, originating from the simple language in article XXIII, developed into A comprehensive system. GATT arbitral practice was promoted as an answer to expanding pressures for a comprehensive system for coping with international trade disputes. The main disadvantage is that the initiation of proceeding depends on the discretion of other states. It seems that in practice, arbitration will play a minimal role in disputes under the WTO, as has happened under GATT. In fact, all claims brought in the WTO context have to be espoused by a member state and need to be lodged against another member country and not an enterprise or an entity. The dispute settlement procedures still engender a great deal of political attention, which seems disproportionate, rather than being arbitral proceedings enveloped with the advantages of international arbitration. Hence, procedures under both GATT and WTO reflect the political negotiation from which they arose.**

The enforcement of arbitral awards under WTO depends upon the economic strength of the losing country rather than the application of legal rules of enforcement of international commercial arbitrations. The applicable law is defined by the treaty rather than by the parties' agreement, although the arbitror decides the arbitral procedure. The discrete character of arbitration is not

Ultimately, the WTO acted definitively. In March 2005, the Appellate Body ruling in case DS 267 declared US cotton subsidies illegal. In March of 2010, Brazil, after the WTO authorized retaliation against the US for anticompetitive subsidies, implemented trade sanctions affecting Ford automobiles.

There is a significant problem around dispute resolution, which is the unilateral act of developed countries, clearly avoiding any submission to the WTO and its dispute resolution system.[17] It is time for an agile and more protagonist system of arbitration in order to avoid the expensive litigation system and to promote concrete decision enforcement.

Better legal support of arbitration, which establishes procedure, benefits and ruling enforcement, is necessary. Instead of the actual sui generis system, establishing rules such as the internationally accepted United Nations Commission on International Trade Law (UNCITRAL) or the ICDR (International Center of Dispute Resolution) would constitute a better solution. A legal mechanism of default in a neutral domain must be established, in which the parties aren't required to be nationals of one of the countries in dispute. Designing neutral venues and establishing the nationality of the chairs and forum in unbiased countries would create a fair

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retained under WTO arbitration. National courts have little role to play in arbitration where the arbitral awards is referred to states.

[17]**Joseph E. Stiglitz, Globalization and its Discontents. 2003, pag. 62. " Matters are perhaps worse still when the United States acts unilaterally rather than behind the cloak of the WTO. The U.S. Trade Representative or the Department of Commerce, often prodded by special interests within the U.S., bring an accusation against a foreign country; there is then a review process-involving only the U.S. government with a decision made by the U.S. , after which sanctions are brought against the offending country. The U.S. sets itself up as prosecutor, judge, and jury. There is a quasi-judicial process, but the cards are stacked: both the rules and the judges favor a finding of guilty. When this arsenal is brought against other industrial countries, Europe and Japan, they have the resources to depend themselves; when it comes to the developing countries, even large ones like India or China, it is an unfair match. The ill will that result is far out of proportion to any possible gain for the U.S. The process itself does little to reinforce confidence in a just international trade system."**

environment to resolve trade questions and greatly improve confidence in the international arbitration process.

More Democracy, Better Business

In virtue of the economic crisis that we are facing, most of the developing countries feel disappointed and in most cases are blaming the acting of the international finance institutions created in Breton Woods, IMF and World Bank, but most the IMF.

The world needs confidence in its institutions, and in its organization, to keep running business, free trade and movement of capitals and services.

There is a strong political movement to reaffirm IMF position as a central role in the international financial system. The G-20 leaders emphatically agreed in a meeting in Pittsburg in June of 2009 to triple the IMF fund lending. They want to give the IMF a principal role in combat this economic crisis, as well as other functions such as an economic forecaster, policy advisor and global lender.

The question now is whether countries affected by this crisis or others before around the world can trust in this institution that has been misusing its mandate by ideological guidelines. IMF assistance was to increase reserves, but never to build schools or hospitals.[18] The IMF evidently exceeded its rule and made several mistakes promoting wrong policies. The best example of

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[18] **Paul Krugman, The Return of Depression Economics and the Crisis of 2008, Page 115First, when the IMF was called in to Thailand, Indonesia, and Korea, it quickly demanded that they practice fiscal austerity- that they raise taxes and cut spending in order to avoid large budget deficits. It was hard to understand why this was part of the program, since Asia nobody but the IMF seemed to regard budget deficits as an important problem. And the attempt to meet these budgets guidelines had a doubly negative effect on the countries: where the guidelines were met, the effect was to worsen the recession by reducing demand; where they were not met, the effect was to add, gratuitously, to the sense that things were out of control, and hence to feed the market panic.**

worn proceeding of the IMF cited by prestigious economists today is the case of Argentina, promoting false expectations in investors about Argentina Public Bonds, which, in the short run, provoked an impossible-to-pay debt, followed by the default of the country's economy.[19]

Large-scale privatization was another of Argentina's policies that resulted in severe damage to the social net, creating high unemployment and social conflicts that led to the overthrow of the government. Privatization was necessary in some parts of the economy, but there were other considerations to address before that.[20] Patently developing countries gave too much credit to IMF and World Bank and Washington policies at that time.[21]

After this loss of confidence in these institutions, countries were reluctant to borrow money, therefore creating a lack of business for the IMF and impelling it to now sell part of its gold reserves to sustain its administrative budget.[22]

The IMF attaches conditions to its loans. These conditions are at the core of the problem because they intrude upon internal political and economic decisions. The IMF and the World Bank measure progress according the country's inflation rate. Obviously using this kind of measure would take them far away from the real problems. Tied to an ideological economic

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[19] **See Mario Cafiero, Javier Llorens, La Argentina Robada, , 2002**

[20] **Paul Krugman, The Return of Depression Economics and the Crisis of 2008, page 40. Part of the plan involved opening Argentina up to World Markets- in particular, ending the long-standing, distributive habit of treating the country's agricultural exports as a cash cow, to be taxed at prohibitive rates in order to subsidize everything else. Privatization of the country's immense and utterly inefficient state-owned sector also proceeded at a rapid clip. (Unlike Mexico, Argentina even privatized the state-owned oil company)**

[21] **Paul Krugman, The Return of Depression Economics and the Crisis of 2008. Pag 98. But look at a map: Argentina is no closer to the United States then it is to Europe, and in fact Argentina does more trade both with European Union and with its neighbor Brazil than it does with the United States.**

[22] http://online.wsj.com/article/SB124078772568857401.html

idea, they have damaged many developing countries.[23] Another excess in the IMF's attributes is its surveillance power, used to impose its measures even in countries that do not need the IMF's aid.[24] Civil society groups are asking the IMF to stop demanding anti-growth, restrictive deficit and inflation targets, exempt health and education spending from government budget ceilings, improve transparency, and undertake meaningful public consultations before agreeing with countries on economic policies. Lack of transparency and absent of democracy is the key question today in the IMF, the same for the World Bank.[25] [26]

Ironically, the idea of establishing the IMF was to centralize the Central Bank System overseeing the international financial system, against the neoliberal school preach against decentralization. "The great advances of the civilization, whether in architecture or painting, in science or literature, in industry or agriculture, have never come from a centralized government."[27] The IMF and the World Bank tirelessly require that their affiliates decentralize and deregulate, while they are both centralized and massive regulators.

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[23] **International Banking Regulation, Carl Felsenfeld.**

[24] **Joseph E. Stiglitz Globalization and its Discontents. 2003 Page 233. Another activity of the Fund is surveillance, reviewing a country's economic performance, under the Article 4 consultations. .. this is the mechanism through which the IMF pushes its particular perspectives an developing countries that are not dependent on its aid. Because on economic slowdown in one country can have adverse effects on others. It does make sense for countries to put pressure on each other to maintain their economies strength; there is a global public good. The problem is the report card itself. The IMF emphasizes inflation; but unemployment and growth are equally important. And its policy recommendations too reflects its particular perspectives on the balance of government and markets.**

[25] **Joseph E. Stiglitz Globalization and its Discontents. 2003. Page 12 The IMF is a public institution, established with money provided by taxpayers around the World. This is important to remember because it does not report directly to either citizens who finance it or those whose lives it affects. Page 12**

[26] **Joseph E. Stiglitz Globalization and its Discontents.2003 Page 8. When projects (in the World Bank), whether agriculture or infrastructure recommended by the west, designed with the advise of western advisers, and financed by the World Bank or others have failed, unless there is some form of debt forgiveness, the poor people in the developing world still must repay the loans.**

[27] **Milton Friedman, Capitalism and Freedom, pag. 3.**

The twenty richest countries that met in Pittsburgh agreed on increasing the IMF fund, didn't plan for a more integrated organization, in which the vote of each country would be the same as the others, regardless their economic situation.[28]

In virtue of IMF and World Bank failures a myriad of new actors have started trying to take chance of those failures and carry those countries-clients to their side. Furthermore, some countries are launching regional banks in Asia and South America for instance defying the IMF and the World Bank. Another more common means of financing countries is through the sovereign funds.[29]

The Case of the Federal Reserve and Central Banks

Presently, bad monetary policies harm commercial transactions. Countries gain markets not because they are competitive but because they devaluate their currencies, basing their economies in an export-oriented economy. This process has been implemented through their central banks, most of them independent agencies from the government but subordinated to the largest banks in their respective country.

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[28] Joseph E. Stiglitz Globalization and its Discontents. 2003 Page 227. "Still, I am not sanguine that fundamental reforms in the formal governance of the IMF and World Bank will come soon. Yet in the short run, there are changes in practices and procedures that can have significant effects. At the World Bank and the IMF there are twenty four seats at the table. Each seat for several countries. In the present configuration, Africa has very few seats simply because it has so few votes, and it has so few votes because, as we noted, votes are allocated on the basis of economic power.

[29] David Smick "The World is Curve" Hidden Danger to the Global Economy, 2009. "If U.S. and European officials woke up tomorrow to a full-fledged global financial crisis, the first five calls ironically would go to the sovereign wealth funds in an appeal for help in achieving stability…" nobody else holds that kind of capital, certainly not the IMF. They (sovereign wealth funds) could be our only hope.'

The United States Central Bank, the Federal Reserve System, as an institution that controls the flow of money in the United States, was established in 1913 to maintain a stable bank system in the country. This kind of organization was promoted around the World trough institutions like the IMF and the World Bank as a fundamental in a democratic country, but as we analyze, not so democratic.

The economic crisis of 2008 raised serious disputes about its existence and juridical nature, and questions to resolve about the economic system's necessity of the Fed, and even more important, whether the current Fed fits in a democratic system.

The Federal Reserve acts set up the link between trade and finance, fixing the interest rates. It cannot be ignored that the Fed has significant leverage beyond any democratic control. To begin, there are a number of unresolved questions, such as what is the Fed's juridical nature? Is the Fed a private institution or a federal agency? Is it a hybrid between public and private institutions? Is the Fed subject to the law and governmental control like every federal agency?

Sections 8 and 10 of Article 1 of the Constitution collide with the creation and function of the Federal Reserve.

Article 1, Section 8: "The Congress shall have Power ...to coin Money, regulate the Value thereof, and of foreign Coin, and fix the Standard of Weights and Measures;" When the Constitution says establishing the value it is not establishing its purchasing power. According to these words the founding fathers viewed money as gold or silver, but not as paper.

The Congress shall have power to coin the money. No clause exists that allows the Congress to subcontract or sub-delegate its power to coin money. The Federal Reserve is not the Congress; hence, it could be viewed as unconstitutional.

Next is Section 10, which relates to the Fed's principal activity, printing money.

Article 1, Sec. 10: "No state shall …make anything but gold and silver coin a tender in payment of debts."

Finally, the Tenth Amendment: "*The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people."*

The probable conclusion of this analysis is that there is no reference to a central bank in the Constitution, and should the Supreme Court accept its existence, under the current Constitution, the Fed cannot tender money.

The secrecy that involves the most important actions of the Federal Reserve affects the business and trade, and the transparency of the system.

The Federal Reserve Board web page states that *The Board will provide any reasonably segregable portion of a record that is requested after deleting the portions that are exempt from disclosure. Under the Freedom of Information Act, 5 U.S.C. § 552 (b), the following records of the Board are exempt from disclosure*, then enumerates the several exceptions: national defense, internal personnel rules and practices, statutory exemption, trade secrets; commercial or financial information, inter- or intra-agency memorandums, information compiled for law enforcement purposes, examination, inspection, operating, or condition reports, and confidential supervisory information, geological and geophysical information and data.[30]

[30] **Federal Reserve Board, FOIA Exemptions: http://www.federalreserve.gov/generalinfo/foia/**

During the 2008 economic crisis, the Fed printed trillions of dollars and circulated them in the form of bailouts. From where that money comes and to where it is going is a good question. After the abolition of the gold standard principle in 1973, the Fed was able to inject money into the market almost limitless. The limit of that action can be established only by the Board of Directors.

It is possible to find the Federal Reserve regulatory malpractice was the seed of the present economic crisis. Furthermore, the Federal Reserve couldn't handle appropriate monetary policies. No institution of the United States government audited the Federal Reserve main decisions.

It is important to remember that at the beginning and during a long part of its existence, the Fed was subjected to the gold-standard system as a regulator. This system consisted in a standard economic unit of account that was a fixed weight of gold, where the government had to guarantee a fixed exchange rate with another country that was on the gold standard. But this system was considered by bankers not elasticity enough therefore affecting the system. Today, through the fiat money system, banks alter the economy, but who paid for that are the tax payers.

This important modification, the elimination of the gold standard, was made in 1970 and buried the Bretton Woods accords. After that, we have seen a different monetary policies around the World, increasing the so call "business cycle" that we have seen more often, while the initial purpose was to stop them.

For those not interested in constitutional issues, the Federal Reserve also failed in most of its commitments. High unemployment, unstable prices, extremely low interest rates, increase of the systemic risk are among of its failures, and this is not all: the worst threaten to the economy is looming, a high inflation, victim of the Federal Reserve hyper-expansionary monetary policies.

But the Federal Reserved succeeded acting as a safety net for the big banks of the country, which act recklessly in the financial market knowingly that in case of trouble they are backed sufficiently.[31]

This weighty centralized bank, outside from the control of the democratic government and without transparency of its acts, weakens the democracy.

New Agricultural Challenges

It has been that in every international trade meeting despite the conflict or different interests between economies, there is always a possibility to reach an agreement, except agriculture. This is the holy side of industrialized countries that anyone can't touch.[32]

Agriculture was the most important part of the economy lasting centuries until nineteen century, when it was displaced by the industry. Industrialized countries looking for new markets brought concerns in international forums. From the creation of GATT to the actual WTO under the principle of non-discrimination negotiations started. The goal was the free trade, the

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[31] **Each emergency rescue only increases banks confidence that they will be rescued in the future creating a cycle of repeated booms, busts, and bailouts. "13 Bankers" Simon Johnson and James Kwak. 2010**

[32] **David M. Smick, "The World is Curve" Hidden Dangers to the Global Economy. 2009. Page 263. "Meanwhile, the signs of globalization's coming demise are everywhere. The WTO, for instance, has steadily lost effectiveness. The U.S. and Europe continue their hypocrisy of protecting agriculture and certain other industries while the Doha Round of international trade talks is stalled. No, the collapse of Doha would not mean global trade has come to a halt, but it would mean that the World has become even more distrustful of universal free trade, which is not a good sign for the future of globalization."**

liberalization of markets. Developing and developed countries gathered in different meetings, but there was just improvement in the liberalization of manufactures, but not in agriculture, which is the developing countries cornerstone of their economies.[33]

Several developing countries have their economies in a pre-industrial era, and the only way to modernize it is exporting their agricultural products and redirection their investments. If the industrialized world close its doors for agricultural products from developing countries, their progress would not be possible.

Japan is a big example of a country which used to be an agricultural economy which experienced a deep mutation to an industrial one.[34]

A new challenger approaches to the agriculture economy today. A growing population around the World will need more food. The price of food will increase soon, and if developing countries can keep their sovereign in their lands, it would be a huge help for their economies. But there are already conflicts around this change.[35]

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[33] For a discussion of globalization, see paper, Cronica del Nacionalismo Toxico, Marcelo Cena, 2009.

[34] David M. Smick, "The World is Curve" Hidden Dangers to the Global Economy. 2009. Pag 58. "In the space of two decades (1953-1973) a largely agricultural nation became the world's largest exporter of steel and automobiles, greater Tokyo became the World's largest and arguably most vibrant metropolitan are, and the standard of living made a quantum leap.

[35] New York Times Magazzine Saudi, Agro-Imperialism? Nov. 2009. "leaders were frightened: heavily dependent on imports, they had seen the price of rice and wheat, they dietary staples, fluctuate violently on the world market over the previous three years, at one point doubling in just few months. The Saudis, rich in oil money but poor in arable land, were groping for a strategy to ensure that they could continue to meet the appetites of a growing population…. There are basically two ways to increase the supply of food: find new fields to plant or invent ways to multiply what existing ones yield.

In those cases, to the defiance of scarce land some countries led them to find other lands. Inflation and hoarding of commodities created panic in industrialized nations dependent on imports. After recent research discovered that countries like Ethiopia had fertile lands for agriculture, the appearance of those countries changed the direction of discovery toward Africa.[36]

As industrialized nations advance upon poor countries' land, a regression toward the worst part of international economy history looms. The same symptoms and excuses apply: semi-slave like working conditions, cheap or free land hidden behind guises such as "creating jobs," "putting risk in our investments by investing in developing countries," and so on.[37]

What happened in Madagascar last year is an excellent example of what is going on in the region. In November of 2008, The Financial Times reported that the South Korean Corporation Daewoo "expected to pay nothing to farm maize and palm oil in an area of Madagascar half the size of Belgium, increasing concerns about the largest farmland investment of this kind."[38] It invoked riots around the country which provoked the overthrow of its president.

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[36] **New York Times Magazine, Nov. 2009. Agro-Imperialism?Ethiopia might seem an unlikely hotbed of agricultural investment. To most of the world, the country is defined by images of famine: about a million people died there during the drought of the mid-1980s, and today about four times that many depend on emergency food aid. But according to the World Bank, as much as three-quarters of Ethiopia's arable land is not under cultivation, and agronomics say that with substantial capital expenditure capital expenditure, much of it could become bountiful. New York Times Magazine, Nov. 2009. Agro-Imperialism?**

[37] **New York Times Magazine, November 2009. Agro-Imperialism?" Later when I asked a couple of workers how much they were paid, they said nine birr each day, or around 75 cents. It wasn't much, but Al Amoudi's defenders (Saudi Arabia construction billionaire) say that's the going rate for farm labor in Ethiopia. They argue that his investments are creating jobs, improving the productivity of dormant land and bringing economic development to rural communities… Ethiopian journalist and opposition figures, however, have questioned the economic benefits of the deals, as well as Al Amoudi's cozy relationship with the ruling party."**

[38] **The Financial Times http://us.ft.com/ftgateway/superpage.ft?news_id=fto111920081227033091**

International institutions, like the United Nations, the World Bank and the World Trade Organization should act to establish order in this context. It is evident that agriculture will play a central role in the new economy; it will feed the World.

There are developing countries whose economies depend upon an 80 – 90% agricultural base. Constrains in the market particularly affect their farmers, and more generally, the possibility of the countries to develop economically.

Unfortunately, who pay for these disruptions to the fee market trade are the consumers, and developing countries are disabled to succeed in their protest. For instance, the sugar price that American consumer is paying for sugar rose to 35.02 cents per pound, while the global price is 19.67 cents. The United States have been imposing quotas and artificially inflated prices in order to protect "American farmers."[39]

The WTO has not succeeded in opening industrialized countries' markets for agriculture products. A new agreement is necessary, to reassess the old claims of helping to enhance developing countries' economies, and take into account the real necessity of those products in an overpopulated world. Protecting them from the abuse of more powerful nations like the cases related above will provide a more stable and safe economy and a more peaceful and fair World.

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[39] **The Wall Street Journal, Price Gap Puts Spice In Sugar-Quota Fight. Mach 15, 2010.**

Conclusion

For the sake of international trade, we are assisting in the death of the IMF. Even though some prestigious economists like Joseph Stiglitz are seeing the IMF working differently than it has been so far, after years of wrongdoing and exceeding its mandate, the IMF must be closed**.**[40] In fact, credibility of the IMF is in serious question. Countries in economic trouble exhaust all possibilities available before looking to the IMF for assistance.

Capitalism without punishment is not possible; hence bank institutions including the IMF in case of failure deserve the punishment for incompetency. Economists, directors and technocrats failed, so they must lose their jobs and the IMF close its doors. That happened millions of times with workers around the world when the factories in which they worked closed their doors in virtue of the IMF's mistakes.

Economics and politics are definitely related, after this crisis there are few people that believe the contrary. This separation had been the bankers' argument to keep them in power of economic decisions around the World. Business negotiations, the exchange rate and balance of payments issues with developing countries must be resolved by implementing business diplomacy and taking into account the new actors on the finance stage. Decisions of countries such as maintaining a fixed or floating exchange rate can be negotiated between governments (like so

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[40] ***"Discussions on the design of the new system are already underway. The United Nations' Commission of Experts on Reforms of the International Monetary and Financial System -- a body I chaired and which included economists, former and current government officials, financial sector participants, central bankers, and business leaders from Asia, Europe, the United States, Africa, and Latin America -- has argued that a new global reserve currency system may be the most important reform to ensure the long-term health of the world's economy; it also suggested how to design an orderly transition from the dollar-based system." Washington Post,*** **Thanks to the Deficit, the Buck Stops Here. August 30, 2009.**

many countries do today) and by international agreements. Up to now, the actions of the IMF in this regard have damaged economies rather than improved economic relations. In order to prevent further harm and more "business cycles," and to promote less poverty and more economic stability, we should have listened Professor Jeffrey Sachs of the Harvard Institute for International Development who advised in 1998:

"*The fund continues to fail in its economic advice. The bailout loans are unfair and ineffective. If we need a new global financial architecture, as Treasury Secretary Robert Rubin has urged, then we need a new architect as well, a thoroughly revamped I.M.F. …The I.M.F's own bad advice destroyed its own forecasts. Every few weeks it has had to renegotiate its Asian programs… the Administration and other financial observers should ask why the I.M.F. can't come close to its own targets. They should ask why many economies under its care continue to stagnate or collapse for years. And they should insist that the I.M.F.'s free run of the international financial system be brought to an end."*[41]

The next case is the Central Bank System (the Federal Reserve System in the United States). A prominent result of democracy, in which the power lies in the citizens who can elect people to represent them, would be to eliminate the central banks' dependency on the largest banks and return it to the citizens.

A new Central Bank System is necessary, dependent on the administration of the government but sharing responsibility for the monetary policy with the Congress. Confirmation from Congress would be needed if a large supply of money to raise or lower interest rates, or especially to address bail outs, were provisionally authorized by the President. This system would be

[41] **New York Times, June 4, 1998, Sec. A, p.27.**

adequate within a democratic system, in which the major decisions that affect the people are determined by the elected governments, with the rewards and punishments that the democracy provides to its elected leaders. Furthermore, this new role would bring more transparency to, hence confidence in the markets, and more business and trade. Within this system, the Federal Reserve's Board of Directors should be elected in a regimented process by the President with confirmation from Congress; two members representing Congress, one from the government political party, the second one from the first opposition party, two representatives from the banking industry, two academics with large trajectory in the matter, and the chairman of the Federal Reserve, directly elected by the President, who will be allowed to vote only to break a tied vote. Congress would need to reform the Federal Reserve Act to reflect these changes.

With respect to the World Bank, in order to survive to the new order, extensive reform is needed. World Bank decisions must be made by the democratic vote of all its members. Nothing is more anti-democratic than the current ballot system, in which the richest countries monopolize the resolutions. Even though World Bank decisions are directed at and affect developing countries, developing countries don't have the power to approve or reject them. Today, the United States has 17% and the Group of Seven (G-7) has 45% of the vote.

The World Bank must restructure and stop its excessive lending conditions. One option would be the creation of decentralized and more independent branches of the Bank in each world region, with a democratic system of votes. Proximity to the people will improve the Bank's performance.

If the real intention is to diminish poverty, the WTO should provide grants instead of loans and interest-free financing investments for poor countries in Africa and Latin America. These actions can be made through the allocation of the IMF's gold reserves.

The international monetary framework that emerged with the collapse of Bretton Woods in the 1970s has proved volatile. A new financial system is essential in any modern economy to boost trade and business. It is necessary that this new financial system link trade and financial policies in ways that create a high national autonomy for governments, which are most familiar with their own countries' domestic issues. With the replacement of the par value system for the fluctuating value system, and with the likely end of the dollar as an "intervention currency," the elasticity that banks around the World have today must be regulated, and one way to do it is through a new and more extensive proposal than the Basel II.

"Free trade is based not just in utility but on justice," said Edmund Burke three hundred years ago. After the economic crisis of 2008, it appears that everything is going to need to be rethought. Not just free trade, but social and political relations as well.

All aspects of international organizations will need to be seriously scrutinized. Countries with extensive economic growth today, like Brazil, China and India, are not at this level of growth because they followed principles rooted in the sermon of the developed world, like private business, free trade, or in some cases, democracy. China's sustainable economy, planned, controlled and managed by the government, is growing fast. Meanwhile, economies such as that of the United States, run by the private sector with lax or no control by the government (before 2008) are shrinking, or, in the case of Japan, in recession since 1990, and generally in trouble.

A more protagonist arbitration system is desirable within the WTO in order to resolve trade conflicts and bring confidence to developing countries, with low cost for everyone, enforceability of arbitration conclusions, protection of land, and sovereignty for the countries whose economies are based in agriculture, in order constitute a necessary matter to reform the system. The same rules that apply to the arbitration process, like neutral venue, or the language of the nations in dispute, can be extended to the reform of old institutions or the creation of new ones.

It is the time to create a new order of business, trade and finance. Democratic international institutions, regional banks with more leadership are necessary, decentralized and independent, and close to the people that their decisions affect.

At the core of this new international agenda is the breaking down of trade barriers, through multilateral negotiations and improvement of the existing agreements. Monetary manipulation of currency in order to gain markets is not acceptable. Business diplomacy will intercede in conflict and a new Basel is needed to regulate the international bank system. This is a call for change, not for a revolution. Otherwise, there is no exit strategy, and the collapse of the current system will effect undesirable consequences.

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